



## **Universal Service Administrative Company**

**Lisa M. Zaina**  
**Chief Executive Officer**

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**July 19, 2004**

**Ms. Barbara Gultinan**  
**Deloitte & Touche LLP**  
**2 Hilton Court**  
**Parsippany, NJ 07054-0319**

**Dear Ms. Gultinan:**

**This letter serves as the response of management of the Universal Service Administrative Company (USAC) to the financial audit and operational reviews conducted by Deloitte & Touche LLP (Deloitte) pursuant to 47 CFR § 54.717:**

- **Audit of USAC's financial statements as of December 31, 2003, and for the year ending December 31, 2003.**
- **Review of the operations and internal controls of USAC, including those of the High Cost, the Low Income, the Rural Health Care, and the Schools and Libraries Universal Service Support Mechanisms as of December 31, 2003.**

**USAC management would like to take this opportunity to express our sincere thanks to the staff of Deloitte for its work on this audit and for working closely with the FCC staff during the course of the audit. We appreciate the professional and timely manner in which staff members conducted themselves during the audit.**

**We are pleased that Deloitte has found that the financial statements fairly present the financial position of USAC and each of the Universal Service Support Mechanisms. We have no comments on the audit of USAC's financial statements.**

**We are also pleased that the agreed-upon procedures reviews found no major concerns with the operating and internal control policies of USAC. We agree with Deloitte's recommendations for process and system improvements. In many instances, we have already acted to address recommendations. In those cases where we have not, we reiterate our commitment to do so. Our specific responses to your review and recommendations are as follows:**

**Comments on the USAC Agreed-upon Procedures Review:**

**GENERAL – COMPLIANCE**

**ITEM 2**

*Deloitte Observation:*

“We obtained and reviewed the FCC rules, Section 54.703(b). We also observed the list of the Board of Directors for both USAC and NECA, to ascertain whether any members served on both boards. This information was extracted from each company’s website.

We found one exception regarding compliance to FCC Section 54.703(b) in terms of the composition of USAC’s Board of Directors. David Conn, who previously represented competitive local exchange carriers, was no longer a member of the Board at December 31, 2003 and this seat was vacant as of December 31, 2003.”

*Management Reply:*

The purported exception is incorrect. The USAC Board of Directors seat representing competitive local exchange carriers was not vacant as of December 31, 2003. On December 11, 2003, Mr. Jonathan Askin was appointed by the Chairman of the FCC pursuant to 47 C.F.R. Section 54.703 to represent competitive local exchange carriers. Mr. Askin was formally elected to the USAC Board of Directors, replacing Mr. Conn, at the December 18, 2003 meeting of the USAC Board of Directors. Thus, Mr. Askin's election to the USAC Board of Directors as the competitive local exchange carrier representative occurred prior to December 31, 2003, contrary to the purported exception. Mr. Askin's election was duly recorded in the minutes of that meeting that were posted on the USAC website no later than February 4, 2004.

**PHYSICAL SECURITY/ INFORMATION APPLICATION SAFEGUARDS**

**ITEM 3**

*Deloitte Observation:*

“We inquired of NECA Low Income IT management their change management policies and procedures and were informed that only two changes were made to the Low Income application during 2003. We were unable to validate that only two changes were made as no log of application changes is maintained. We noted that both requests were made by USAC management to NECA IT management; however, documented approval of these changes was not obtained. We noted that the changes were deemed to be minor in nature and formal documentation of the design, development, and testing processes was not maintained.

In addition, we obtained the Low Income Migration Forms for the application modifications, dated March 11, 2003 and August 5, 2003, and noted that while the forms requested that the development change be migrated from the UAT to the PROD environment, we were unable to ascertain that the changes were actually tested in the development environment prior to implementation.”

*Management Reply:*

USAC has a formal change management process in place with Telcordia and this is used for Low Income and High Cost system changes. While D&T had opportunity to review testing from the NECA environment in 2003, we have ensured that Telcordia performs testing in their DEV environment prior to code being rolled into PROD.

**ITEM 4**

*Deloitte Observation:*

“We obtained documentation for the High Cost Excel spreadsheets initiative, for the period January – November 2003 and noted that the spreadsheets used prior to September 2003 did not include security features. This feature was introduced with the implementation of the new web-based application, which could not be tested for security, because the application was transferred to Telcordia prior to the start of our testing. We noted that the documentation stated that the security parameters met or exceeded those specified in the information processing manual.

We were unable to obtain the documentation for the High Cost Webserver initiative and the High Cost Windows Webserver for the period January - November 2003. We noted that the documentation stated that the security parameters met or exceeded those specified in the information processing manual.

We were unable to test security for the Low Income initiative for the period January - November 2003 as the application had been transferred to Telcordia prior to the commencement of our testing. We noted that the documentation stated that the security parameters met or exceeded those specified in the information processing manual.

We obtained an automated security report for the LI AIX Server for the period January - November 2003 and noted that security on the server was found to be average. We obtained two BindView reports, dated April 3, 2003 and December 30, 2003, for the Novell LAN Server and noted the Novell Netware Intruder Detection Settings. We noted that unauthorized attempts to access the Novell Netware are not logged; however an account is locked after 3 incorrect login attempts.”

*Management Reply:*

USAC has verified that protection of the feeder files at Telcordia is achieved through restricted access utilizing user accounts. Therefore only appropriate staff working on the High Cost and Low Income support mechanisms has access to systems/files relevant to their work.

Telcordia is utilizing their network operating system A&A (Authentication & Authorization) to restrict access to the files. Telcordia has a dedicated server for this feeder files purpose that is only accessible to staff working on the contract. The server is further protected by a firewall. USAC has diagrams of the network and logical

architectures as well as a report detailing access to the individual systems/files. The systems/files involved include the following:

- LSS -- Local Switching System (Access App)
- IAS -- Interstate Access System (Access App)
- ICLS -- Disaggregation system (Access App)
- HCM -- High Cost Model System (Excel Workbook)
- SNA -- SafetyNet Additive System (Excel Workbook)

## **ITEM 9**

### *Deloitte Observation*

"We inquired of the Executive Director - Information Systems the procedures for job scheduling and process and noted that three processing jobs are activated and monitored by the Operations department in support of the Low Income application. Each month, upon receiving proper authorization from the High Cost/Low Income Application Manager; the first job is activated. When successfully completed, notice is sent to the High Cost/Low Income Application Manager who then authorizes activation of the second job. The same process is then followed until the third job is activated and completed. If processing exceptions occurred, the restart/recovery procedures outlined in each respective document were followed. We noted that documentation of this process was not maintained by the Operations department; but rather by the High Cost/Low Income Application Manager. Because of the application transfer from NECA to Telcordia in December 2003, we were unable to perform these agreed-upon procedures".

### *Management Reply:*

Telcordia has provided USAC with the current process flow and documentation for the job scheduling to support the Low Income application. USAC believes these documents show that the systems execute timely transactions in the proper sequence to normal completion.

## **CONTRIBUTORS TO USF**

## **ITEM 5**

### *Deloitte Observation:*

"D&T selected a sample of Form 499s that were received by USAC, from the 499Q November 1, 2002 filing, 499Q February 1, 2003 filing, 499Q May 1, 2003 filing, August 1, 2003 filing, and the 499-A April 1, 2003 filing, and performed steps a-d below.

- a. Recalculate the form for clerical accuracy and completeness.
- b. Trace the name of the carrier, address, and I.D. #, to the USAC carrier database.
- c. Note that the service provider has certified the form.
- d. Ascertained if the forms have been reviewed for reasonableness by USAC personnel.

We noted that three Form 499s were not legible. Filer ID #s 820076 and 819366 (May 2003 Form 499Qs) and Filer ID # 802101 (August 2003 Form 499Q).

We found that for Filer ID 819688, Asiatone, LLC, the following was not completed on the filer's May 499Q:

- Line 119 – Projected gross-billed end user revenues
- Line 120 – Projected collected end-user revenues

We also noted that this filer's Form 499Q was not initialed by a member of staff at NECA to verify that it was reviewed for reasonableness.

For the following filers, we noted that the Form 499Q was not dated by the filer:

- Filer ID 801048, Wikstrom Telephone Company, Inc., February Form 499Q
- Filer ID 820061, Birch Telecom of Oklahoma, Inc., May Form 499Q
- Filer ID 818014, Ernest Communications, Inc., August Form 499Q
- Filer ID 819516, Essen Communications, November Form 499Q
- Filer ID 818666, Consolidated Lauco Systems, November Form 499Q

*Management Reply:*

Illegible Form 499s: Disagree. On March 24, 2003, Serafin Icasiano of D&T wrote an email to Eric Bime indicating that the faxed copies of the 3 above mentioned forms were illegible. At that time, Eric faxed replacement copies that were legible. We have reconfirmed with Serafin that he did receive those forms and that the copies were legible when not submitted via faxed copy.

Asiatone: Disagree. On May 20, 2003 a voicemail was left by the 499 DCA for Mr. Nils Johnson of Asiatone regarding lines left blank on the May 1, 2003 499-Q (119 and 120). The voice-mail asked for Mr. Johnson to call the 499 DCA to fix this error. Again, on May 29, 2003, a second voice-mail was left by the DCA for Mr. Johnson regarding the same error. Neither call was returned by Asiatone. As a result, per DCA procedures Section 10.4, the May 1, 2003 499-Q was estimated by taking the relevant lines on Asiatone's April 2003 499-A divided by four. Section 10.4 of the DCA procedures state "There are two situations in which the revenue will be estimated for a particular company's filing: 1) company has failed to respond to their filing obligation (called a non-responder) and 2) company has failed to clarify and/or respond to a questioned filing."

Attached to the original May 1, 2003 499-Q for this company is a memo from the 499 DCA dated August 14, 2003, indicating that this provider had been contacted in an attempt to resolve inquiries regarding the revenue reported but despite DCA efforts, the company did not respond to our questions, thus the revenue was estimated.

Per procedure, the Form 499-Q was not initialed by a DCA staff member because the form was approved to process as received. An initial on a form indicates not simply that the form was reviewed for reasonableness, but an initial means that it was reviewed AND that it passed all the reviews necessary to process as is.

**Not Dated by Filer:** Disagree. The 499 DCA captures the dates necessary for USAC invoice processing: 1) the date the form was received by the DCA, whether via paper or online and 2) the date the worksheet was post-marked (for companies filing after the 5 business-day grace period). For the post-mark date, the 499 DCA retains the actual envelope the worksheet was mailed in. Per procedure, omission of the date on their worksheets is not considered a reject reason since the dates described are captured.

#### **ITEM 6**

##### *Deloitte Observation:*

“We inquired of USAC management the procedures in place which ensure that revenue information obtained from the FCC Form 499 database is accurately summarized and reported to the FCC for its calculation of the contribution factor. We were informed by USAC that the process includes comparing and agreeing the total revenue reported and the number of filers contained in the FCC Form 499 database received from NECA to the details provided by NECA. We were also informed that the revenues reported in the Form 499 database are reduced by the Local and International Revenue Exception (“LIRE”) and de minimis exemptions and is reviewed by a member of the USAC contributions team before submission to the USAC Finance Manager. We requested, but were not provided with, any written documentation to verify that these processes had taken place in 2003. The noting of any differences between the information aggregated by USAC and the information sent to the FCC was performed under step 7a.”

##### *Management Reply:*

USAC initiated a quality control process in May 2003 to provide the referenced processes are being done. USAC has made available the documentation for the May through December 2003 period.

#### **ITEM 7**

##### *Deloitte Observation:*

“We selected 10 filers and verified that these filers had submitted their Form 499s and then agreed the revenue report in the 499 Preliminary Revenue Hand-off schedule to the USAC support database.

We found that for Filer ID 819688, Asiatone LLC, the contribution base per USAC’s quarterly contribution base database did not agree with the filer’s 499Q for the respective period. We further noted that the aforementioned information could not be agreed because it was not supplied on the Form 499Q; which was already noted as an exception in Step 5.”

*Management Reply:*

USAC management disagrees with the auditor's observation. The revenue for Filer ID 819688, Asiatone LLC was estimated per 499 DCA Procedures Section 10.4 as explained above in #5. The estimated revenue figures in the 499 system match those that were sent to USAC as a basis for invoicing.

**ITEM 8**

*Deloitte Observation:*

"We inquired of USAC the procedures in place which ensure that the contributor's historical data is current. We obtained the database that compares the historical data to the current data and haphazardly selected contributors with variations greater than 20%. Five of the selected contributors were calculated as being de minimis therefore no further investigation was performed by NECA. For three of the remaining four contributors, we obtained copies of email correspondence in which NECA inquired of the contributor and the contributor responded with an explanation for the variance in their revenues reported. No additional information could be provided for the remaining contributor as NECA's investigation has not yet been concluded."

*Management Reply:*

We acknowledge that the review had not been concluded of this referenced filer however; per procedure the review list is prioritized by the highest impact, and this filer was of lower priority. The procedure was followed.

**ITEM 9(e)**

*Deloitte Observation:*

"We agreed the subsequent carrier receipts to the invoices by obtaining the available supporting documentation, including check images from the bank of the checks deposited into the lockbox and bank reports of ACH receipts. We noted three exceptions: National Telemanagement Corporation, Asiatone, LLC and Ameritech Mobile Communications, Inc. USAC management informed us that discrepancies between the amount received and the amount billed are only followed up for the 20 largest filers. The three exceptions were not one of the 20 largest filers and therefore were not investigated by USAC."

*Management Reply:*

Per procedure, follow up is performed only when one of the 20 largest filers fail to pay in full. Filers that are delinquent are issued collections letters and are subject to Debt Collection Improvement Act transfers to the FCC and Treasury.

**ITEM 9 (f)**

*Deloitte Observation:*

"We agreed the daily lock box total to ACH receipt reports, check images and/or remittance slips from the bank. We were unable to agree directly to bank statements due to individual payments being made as part of a larger transfer".

*Management Reply:*

As stated, the bank statements for the lock box service reflect daily totals and not individual transactions. The individual transactions are reported on daily lock box reports which are then reconciled to the daily bank statement balances. This process in no way affects our ability to reconcile bank transactions at the individual transaction level.

**ITEM 10**

*Deloitte Observation:*

“We obtained USAC management’s criteria and procedures for the process of adjusting contributor liability amounts (amounts billed and amounts due from contributors) or account balances and performed steps as specified. We obtained a list of carriers that amended their Form 499Q revenue amounts and selected a random sample of 10 carriers to determine that the revenue amount used for billing corresponds to the amount per the amended Form 499Q.

In performing a recalculation of the monthly adjustment, we noted that for Filer ID 803178, Randolph Telephone Company, the \$996.15 adjustment did not agree to the \$11.14 adjustment per the April 2003 invoice provided by USAC”.

*Management Reply:*

Disagree. Filer ID 803178, Randolph Telephone Company, was appropriately given Support Mechanism Adjustments on the April - June 2003 invoices for their revised November 2002 499Q. In November 2002 when the form was due, revenue was estimated by the 499 DCA per procedure. Prior to the calculation of January 2003 invoice charges, the estimate was updated with actual revenue filed by the company. Subsequently, that actual revenue was revised by the Filer, and processed on the April invoice. It appears that Deloitte used the original estimate to compare to the April revision (which yields adjustments of \$996.15), whereas the comparison is between the late filed form and the revision (which yields adjustments of \$11.14). Randolph was never billed on the estimate.

**ITEM 13**

*Deloitte Observation:*

“In performing the above procedures, we used the invoices tested in step 9 and obtained supporting documentation for the payment subsequent to the invoice. We then tested to see if the cash receipt was applied to the appropriate carrier.

We found an exception relating to Filer ID 820061, Birch Telecom of Oklahoma, Inc. The balance due from this filer was \$8,289.19. However, the subsequent payment applied to this filer was \$366,066.70. This occurred as the result of USAC erroneously applying the total amount of a check to a single filer when the check was intended to settle the balances of multiple filers. We further noted that USAC subsequently corrected the error in the ordinary course of business.”



*Management Reply:*

We agree with the auditor's observation. Birch Telecom submitted a single check for \$366,066.70, which they intended to be split amongst multiple Filer Ids. The company attached this check to their Invoice Payment Coupon for only Filer ID 820061, on which they filled in the amount to be applied as the entire \$366,066.70. LaSalle bank uses the payment coupons to data enter information to the daily payment feed and thus the full amount was coded to the single filer ID, 820061. Birch did provide a separate payment break out on another page with their check, however, the manual review by USAC Collections of this payment overlooked that additional sheet and applied based on the payment coupon, which was the first document, as the direction to apply the payment. Each month, USAC Collections already performs a review of the accounts with the top 10 credit balances as a quality control step. USAC Collections will extend this control step to review each payment that results in a credit balance to ensure that the payment has been applied appropriately.

**HIGH COST SUPPORT MECHANISM**

**ITEM 14**

*Deloitte Observation:*

"We recalculated the competitor's support received in the third quarter 2003 to ensure that it was in accordance with applicable FCC rules. We ensured that the carrier's support amount was computed based on the disaggregation path selected. We compared the recalculation to the NECA detail disbursement authorization and noted a difference of \$40 for Grand River Mutual of Missouri. However, we noted that the calculation of cost and expense data for HCL is subject to NECA's role under Part 36 of the FCC rules, and as such were advised by USAC management not to investigate this matter further."

*Management Reply:*

NECA has independent responsibility under Part 36 of the FCC's rules to calculate High Cost Loop (HCL) support for incumbent carriers. Because NECA calculates HCL support and USAC disburses the exact support amounts calculated by NECA, USAC and Deloitte agreed that this HCL finding was outside the scope of this audit. Therefore, USAC and Deloitte agreed that USAC did not need to research this finding any further.

**ITEM 40**

*Deloitte Observation:*

"We inspected the 2001 LSS forms for 5 incumbent carriers, in order to obtain the projected line counts submitted October 1, 2000. We then obtained the true-up forms filed in December 2002 and compared them to the FCC filing true-up amounts. The following exceptions were noted":

SPIN	SAC	State	SA Name	October 2000 Projections	December 2002 Actuals	True-Up Actual FCC Filing	Difference

143002559	492270	NEW MEXICO	PENASCO VALLEY TEL	\$903,138	\$773,233	\$773,214	\$19
143002238	391667	SOUTH DAKOTA	KADOKA TELEPHONE CO	\$196,865	\$254,149	\$299,898	\$(45,749)

*Management Reply:*

The LSS factor for both Kadoka Telephone Company and Penasco Valley Telephone was not capped at 85 percent, which is required under section 54.301(a) of the FCC's rules. For carriers whose uncapped 1996 weighted DEM factor exceeds the 85 percent cap, the LSS factor should be capped at 85 percent. Since these two carriers' LSS factor was not capped, USAC will recalculate the 2001 LSS true-up amount using the 85 percent cap and will adjust the carriers' support accordingly.

**ITEM 45**

"We obtained from USAC, the October 2000 Projection and the FCC True-Up Filing. The true-up difference is the recalculated true-up amount provided to the incumbent carrier. We then compared the true-up difference to the April 2003 Disbursement Authorization report, which details the true-up amount actually disbursed to the carriers for the funding year 2001. The following exceptions were noted":

SPIN	SAC	SA Name	October 2000 Projections	True-Up Actual FCC Filing	True-up Difference	April Disbursement Authorization	Difference
143001536	250283	Brindlee Mountain	\$428,202	\$418,442	\$9,760	\$9,754	\$6
143001736	320771	Greetingsville Tel. Co.	\$41,289	\$48,714	\$7,425	\$7,422	\$3
143001690	310671	Century Tel. Midwest	\$685,904	\$615,564	\$70,340	\$69,936	\$404
143002559	492270	Penasco Valley Tel.	\$903,138	\$773,214	\$129,924	\$132,594	\$(2,670)
143002238	391667	Kadoka Telephone Co.	\$196,865	\$299,898	\$103,033	\$87,222	\$15,811

*Management Reply:*

USAC Management is unsure where Deloitte obtained the LSS projections for 2001 used in this finding. In the 2001 LSS true-up calculation, USAC used the LSS projections reflected below. These LSS projections are consistent with the amounts reflected in the 4Q2001 FCC filing (Appendix HC05) and the 2001 LSS true-up appendix in the 3Q2003 FCC filing (Appendix HC18). Moreover, USAC does not believe this is a finding because USAC's calculations match the amounts included in the April 2003 disbursements.

SAC	SA Name	LSS Projection	LSS Actual	True-Up Amount
320771	Greetingsville Tel.	\$41,292	\$48,714	(\$7,422 )
310671	Century Tel Midwest	\$685,500	\$615,564	\$69,936
	Penasco Valley	\$905,808	\$773,214	\$132,594
391667	Kadoka Telephone	\$212,676	\$219,898	(\$7,222)

## LOW INCOME SUPPORT MECHANISM

### **ITEM 2 (b)**

#### *Deloitte Observation*

"We made a selection of 45 Low Income Support Carriers from the August Disbursement Report for the nine months ended September 30 and traced each disbursed amount (Lifeline, Link-up, and Toll Limitation Services) to the Form 497 submitted to USAC or NECA by the carrier. In order to verify that July's true-up amount was accurate, we summed the actual and projected support for the month of July, from the most recent version of the Low Income Table. We then compared this amount to that on the Form 497 submitted by the carrier. We noted that these two support amounts agreed with the exception of the following:"

SPIN Name	Study Area Code	Serving Area Name	Lifeline	LinkUp	TLS	July Actual Total Support	Actual Amount per July 497	Difference
Midwest Wireless Holdings, LLC	359010	Midwest Wireless	\$463	-	-	\$463	\$483	\$(20)

#### *Management Reply:*

The majority of carriers claiming Low Income support submit their FCC Forms 497 by fax. The faxed copies are often slightly distorted. In this case, USAC management believes that the "8" on the carrier's FCC Form 497 was misread as a "6." USAC is in the process of conducting outreach to carriers to encourage them to submit their FCC Forms 497 electronically, and we will be introducing on-line form submission in 2005. These steps will reduce the occurrence of this type of error.

USAC will adjust Midwest Wireless's support consistent with this finding.

## RURAL HEALTH CARE SUPPORT MECHANISM

### **ITEM 22**

#### *Deloitte Observation:*

"For the period ended September 30, 2003, we noted a difference between the total disbursements per the USAC G/L and the total RHC approved amount as follows:

Total disbursements per USAC G/L	\$16,229,782.03
Total RHC approved payments for 2002	<u>\$16,229,755.56</u>

Difference

\$ 26.47

The difference was due to a bankruptcy court ruling. The court ruled that USAC should return a portion of a carrier payment. This amount was allocated across all the support mechanisms."

*Management Reply:*

We concur with the observation noted. This exception does not require any corrective action because this General Ledger (G/L) adjustment was the result of a bankruptcy court ruling and is required to be allocated among all USF support mechanisms as noted by the auditors.

**ITEM 29**

"We made 10 selections of appeals initiated by the HCP and for this sample we obtained the appeal and applications folders from USAC and NECA based on the selections, and agreed the HCP name and appeal date from the appeal logs to the application folder. We then compared the date received and the appeal correspondence to the date of the Funding Commitment Letter to verify that the appeal was in compliance with the 60 day FCC rule.

For the sample item tested below we noted that the HCP number within the data file was different from the number traced in the applications folder. We found through inquiry of management that this arose due to a manual error and has been amended by USAC".

Appeal	HCP#	HCP
U02-6-1	11064	Iliuliuk Health and Family Services

*Management Reply:*

This item involved the transposition of digits associated with applicant correspondence and had no impact on funding. As stated above it was a manual error, not a procedural error and we concur.

**SCHOOLS AND LIBRARIES SUPPORT MECHANISM**

**ITEM 20 (c)**

*Deloitte Observation:*

"We compared the designation of rural or urban for 9 of the 55 applications included in the selected FRNs to information contained within the Block 4 data file, noting agreement. However, as a determination of the rural or urban designation may only be made at the detailed entity level, we were unable to agree the remaining 46 application selections because they were either a school district, library or consortium consisting of a number of entities".

*Management Reply:*

This is correct and according to procedures. The rural or urban designation is only assigned to an entity receiving services and not billed entities.

**ITEM 26 (b – iii)**

*Deloitte Observation:*

“For each of the 20 denied FRNs selected, we recalculated the percentage of ineligible services to the total funds requested and compared the percentage calculated to the supporting schedules and calculations provided by USAC SLD, and noted one exception. For FRN #986526, we reviewed the supporting documentation and noted the FRN was improperly denied for support. However, we were informed by USAC SLD that this FRN was appealed and the appeal will be granted.”

*Management Reply:*

The audit finding is correct and the appeal should be granted.

**ITEM 34**

*Deloitte Observation:*

“For each FRN we compared, the sum of the approved (discounted) payment amount, per the Invoice Payment data file, to the approved funding commitment, per the commitment data file. We noted that for any excess payments identified the amount was properly recorded in the COMAD database. For FRN # 986526, we noted the approved (discounted) payment amount, per the Invoice payment data file was greater than the committed amount, per the commitment data file. However, we were informed by USAC SLD that this is in accordance with approved procedures as this FRN is in the recovery process.”

*Management Reply:*

No response is required as there is no exception to procedures.

**ITEM 38**

*Deloitte Observation:*

“With the exception of 108 FRNs, FRNs with approved payment amounts per the invoice payment data file were listed as “Committed – Full” per the commitment data file. 108 FRNs are in the COMAD system, either going through the recovery process or have been successfully recovered by USAC; although, 5 of the 108 are currently under investigation.”

*Management Reply:*

All five FRNs were a result of a fallacy in procedures. A commitment reduction may be recorded, but the reduced commitment will not affect the database until it is processed through the Commitment Update Process (wave). This may be as much as a month from the date the commitment reduction is entered. If an invoice is approved for payment before the wave, it is possible that a payment may be made in excess of the adjusted commitment amount. SLD will modify its systems to guard against this possibility in the

future. SLD will process Commitment Adjustments and seek recoveries as required to correct the five FRNs. Additionally, SLD will review all disbursements authorized to date to identify any additional payments made in excess of the funding commitment.

**ITEM 40 (a)**

*Deloitte Observation:*

"We inquired and tested the procedures and controls in place that provide reasonable assurance that the amount of funding available for the new service provider is limited to the amount committed on the FRN less the amount paid to the original service provider. We randomly selected 45 service providers with SPIN changes and noted that additional payments were not made to the new service provider until a SPIN change had been fully processed and recorded in the Oracle system. For application #242088, we were not provided with SPIN request letter to support the applicant certification."

**ITEM 40 (b)**

*Deloitte Observation*

"We inquired and tested the procedures and controls in place that provide reasonable assurance that USAC did not make additional payments on the FRN until the SPIN change was reviewed and either (1) approved and the SPIN was changed or (2) denied and that USAC verified that additional invoices were for services actually rendered to the applicant by the original provider. We obtained the SPIN change documentation and noted that no invoices were paid until the SPIN number request was approved. For application #242088, we were not provided with the SPIN change documentation, as we were informed that there has been no SPIN change for this application. Further, we did ascertain that no invoices were paid on the FRN."

*Management Reply:*

A review of Form 471 #242088 does not indicate that a SPIN change (or any other change) was processed against the application. The item was entered into the database used to track correspondence in error and was so noted in the database.

**ITEM 54**

*Deloitte Observation*

"For each of the 45 Year 2003 appeals selected, we obtained the selected appeal and noted, without exception, the applicant name and appeal date to the Appeals data file. We observed that the appeal correspondence was postmarked within the 60-day appeal window from the date the Funding Commitment Letter was mailed or the date of the 486 notification letter. However, for application # 292868, we were unable to obtain the supporting documentation for the appeal. We were informed that the record in the appeals database was created because of a data entry error in the application number. An additional record was created for the correct application # 292686 and processed in accordance with approved procedures. We were further informed that the erroneous record was not deleted in order to maintain database integrity."

## DISBURSEMENT PROCESS

### **ITEM 2 (b)**

*Deloitte Observation:*

"We inspected each of the Form 498s selected and noted if they were accompanied by a signed letter on company letterhead, attesting to the accuracy of the information submitted. We noted three exceptions for SPIN #s: 143002238, 143002342, and 143001736. However, we ascertained that the lack of a signed letter on company letterhead was acceptable as these three service providers had not filed a revised Form 498 since 1998, which was the effective date for this requirement."

*Management Reply:*

We concur with Deloitte's assessment that this is not an exception.

### **ITEM 8 (a)**

*Deloitte Observation:*

"We obtained from the ABCD the HCL, LSS, LTS, IAS, ICLS, HCM and SNA payment amounts for March 2003, May 2003, July 2003, August 2003 and November 2003 and performed the following:"

- a. For the months selected, we compared the total monthly support payments per the disbursement authorization form to the disbursement report for non-pool participants and to the EC 2100 or Adjustment report for pooled participants. We noted the following differences:

Month	Support	Difference
March 2003	High Cost Loop	\$(1,708,914)
March 2003	High Cost Model	\$ 1,708,914
May 2003	High Cost Loop	\$(2,126,056)
May 2003	High Cost Model	\$ 2,126,056
July 2003	High Cost Loop	\$(2,566,378)
July 2003	High Cost Model	\$ 2,566,378

*Management Reply:*

Prior to the August 2003 disbursements, High Cost Loop (HCL) support and High Cost Model (HCM) support were combined on one disbursement report. On the disbursement authorization report, however, HCL support and HCM support were listed separately. While this practice resulted in the differences noted in the table above, there was not a discrepancy between what was authorized and what was disbursed in the months that were reviewed.

With the transition to a new High Cost system in August 2003, separate disbursement reports are now created for HCL support and HCM support. As a result, the differences noted in the table above no longer occur.

#### **ITEM 11**

*Deloitte Observation:*

“We inquired of USAC management, USAC Billing and Disbursement personnel and NECA the procedures in place to inform USAC that the support payments authorized for payment were paid, and were informed that for payments to non-pool participants a monthly analysis of outstanding checks and payments is performed. We were informed that for payments to NECA pool participants there is no process in place to inform USAC that what they had authorized for payment has been paid. We ascertained that there are no controls in place, beyond the point of submitting funds to NECA and disbursements to LaSalle Bank, which confirm payment to the carrier.”

*Management Reply:*

We disagree with auditor’s observation. Effective as of November 2003, the new Form 498 requires each recipient of High Cost and Low Income to expressly authorize USAC how to disburse its support payments through these two mechanisms. A carrier could elect to have its payment disbursed to NECA, in which case the carrier would provide NECA’s banking information in the remittance section of the Form 498. For these carriers, NECA acts as an agent of the service provider to whom funds are due. USAC’s obligation is fulfilled when the payment made to NECA is complete.

#### **ITEM 14**

*Deloitte Observation:*

“We compared the FCC fourth quarter 2003 projected demand filing to the summary of the amounts netted against contributions and/or disbursed directly to carriers for the fourth quarter 2003 and noted that in total the amounts netted and/or directly disbursed did not exceed the total FCC projected demand. We noted that by Support Mechanism, the amounts netted against contributions and/or disbursed directly to carriers for the High Cost, Low Income, Rural Health Care, and Schools and Libraries Support Mechanisms did not exceed projected demand by Support Mechanism by \$29,254,000, \$4,299,000, \$4,709,000 and \$764,477,000, respectively.”

*Management Reply:*

The FCC projections are estimates of future demand. As such they will usually vary from the actual amounts disbursed. We agree that the above statement properly reflects the variance for fourth quarter 2003.

#### **ITEM 15**

*Deloitte Observation*

“Using the sample of 45 Rural Health Care disbursements selected in Rural Health Care step 19, we noted that 38 of the disbursements were netted and 7 disbursements were not netted. For 38 disbursements that were netted, we agreed the disbursement credit to the



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carrier receivable balance. We also noted that the 7 non-netters were not contributors to the Rural Health Care Support Mechanism.

For six disbursements that were not netted, we obtained the Form 498s and noted that the service provider elected not to net. For one disbursement (SPIN #143010651, invoice amount \$52,853) that was not netted, there is no record of payment; however, we inspected the NECA disbursement authorization file and noted that the invoiced amount has been authorized.”

*Management Reply:*

Disagree. The documentation that demonstrates that SPIN # 143010651 was paid \$52,852.54 was provided to Deloitte. SPIN # 143010651 is listed in our database as “De Minimis” and therefore their disbursements were not netted against their contribution even though they have a filer id (# 816972) per procedure. The invoice number from this SPIN was #18581861 for \$52,852.54. The authorized disbursements were paid directly to the service provider via two check payments since the invoice covered two different funding years. The two checks dated 2/25/03, check # 0230039850 for \$6,250.00 and check # 0230039852 for \$46,602.54, totaled \$52,852.54. Copies of the payment information were provided to Deloitte in a timely manner.

Sincerely,



Lisa M. Zaina  
Chief Executive Officer

cc: Mr. William Hill, FCC  
Mr. William Maher, FCC  
Mr. Anthony Dale, FCC  
Mr. Jeffrey Carlisle, FCC